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STUDENT : **Martin Slon**

TITLE : **On-line brokerages : marketing strategies and effectiveness, Ameritrade vs E*Trade**

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ON-LINE BROKERAGES:
MARKETING STRATEGIES AND EFFECTIVENESS

AMERITRADE VS E*TRADE

by

MARTIN SLON

A research paper submitted in fulfillment of the requirements for 3.0 credits,
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Professor T.C. Kinnear, Faculty Supervisor

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Faculty Comments

This is a truly excellent presentation of the competitive wars between the two major e-commerce brokers.

Grade: EXCELLENT

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Title

1 Executive Summary

On-line equity brokerage is a new industry – in 1995 there were no on-line brokers, by the end of 1998 there were approximately 100. Between January 1997 and December 1998, two of these on-line brokerages, Ameritrade and E*Trade, spent over $190M on marketing their services.

This paper examines the marketing strategies taken by Ameritrade and E*Trade, publicly held on-line brokerages. Ameritrade has followed a more targeted campaign than E*Trade, and also benefited from moving first in the rapidly escalating marketing efforts of the on-line brokerages. These two companies spent approximately 18% of their revenues on marketing in 1997, compared to a general brokerage industry average of 1.8%.

Both companies compete in the deep discount brokerage sector, but neither has yet established a uniquely differentiated value proposition or has managed to create a sustainable competitive advantage. Both are increasingly competing on offering increased investing information, and both are at varying stages of transforming themselves into financial portal sites. E*Trade has been more aggressive in this repositioning and is spending heavily to attract customers. Both companies have grown dramatically in absolute terms in the period under review, but Ameritrade has seen their market share grow from 3% to 8%, whilst E*Trade's share has declined from 15% to 12%.

Ameritrade spent proportionately more of its advertising dollars on traditional media than E*Trade. An economic analysis shows that Ameritrade has been more cost-effective in their customer acquisition costs, performing better on all metrics used, which may indicate that on-line advertising is less cost-effective than off-line advertising. It is the writer's contention that E*Trade may well be spending more than is economically viable in its customer acquisition drive. However, there are substantial growth opportunities using the Internet channel, and it remains to be seen whether E*Trade can capitalize on these opportunities.

2 INTRODUCTION

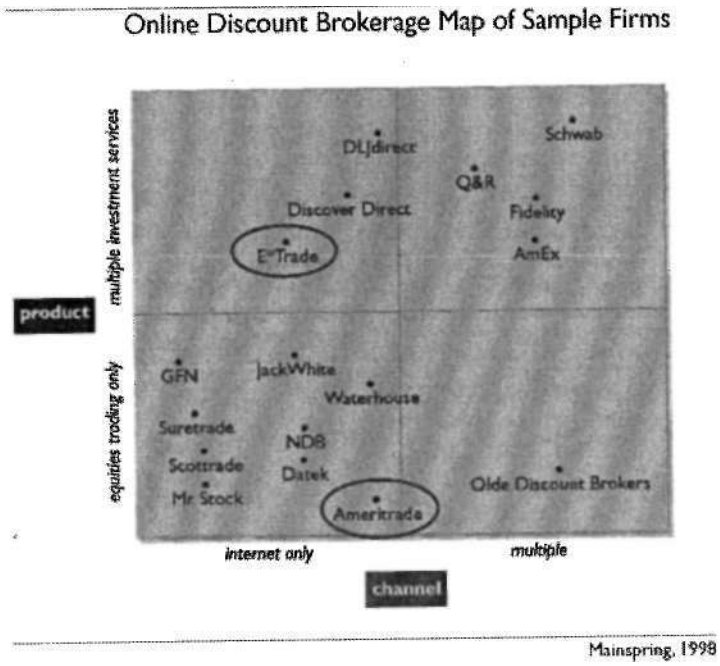
On-line equity brokerage is a new industry - in 1995 there were no on-line brokers, by the end of 1998 there were approximately 100. Between January 1997 and December 1998, two of these on-line brokerages - Ameritrade and E*Trade - spent over $190M on marketing their services. In terms of new customers, this amounts to about $300 per account. But how efficiently was that marketing money spent in the brave new world of on-line services?

This paper will examine the different marketing strategies taken by Ameritrade and E*Trade, between September 1996 and December 1998. These companies have been chosen because they are both public and their primary business is on-line brokerage. This allows the author to make direct comparisons and draw conclusions regarding the marketing of on-line businesses. The paper will examine how much money was spent, how it was spent, who it was targeted at and analyze the effectiveness of the marketing spending. It will specifically attempt to determine, by comparing the client acquisition costs of the two companies, the efficacy of on-line marketing programs.

3 ON-LINE BROKERAGES

The on-line equity trading industry is experiencing incredible growth, and its constituents are different from other hot web companies in that some companies are actually profitable!

These on-line brokerages have one of two heritages. One is the extension of an existing brokerage business that treats the Internet as just another channel. The second is those firms whose business model has either evolved into, or were explicitly designed as, a purely web brokerage.



Mainspring, S 998

Fig 1: Perceptual Map of Selected Brokerages[1]

The two brokerages selected for this study, Ameritrade and E*Trade are both of the latter type, and both are publicly held. Being pure Internet brokerages allows for direct comparison.

[1] Mainspring; Online Brokerage Business Model Dictates Metrics Employed; November 1998; http://www.mainspring.eom/FreeAll/SearchFrameset/l, 1281,0,00.htmi

3.1 BUSINESS MODEL

Revenue for securities brokerages comes from four areas:

3.1.1 Brokerage commissions

A fee is due from customers each time a trade is executed. Traditionally these fees were in the hundreds of dollars per trade, but on-line brokerages have seen these fees reduced to as low as $8 per trade in Ameritrade's case.

3.1.2 Payment for order flow

A particular security will have a number of market makers whose role is to be the primary dealers (and thus price setters) for that security. They are the ones who buy shares from a seller and then find a buyer to sell them to (they will hold them temporarily if there are no buyers). They earn their profit from the spread – the difference between the buy and sell prices. Brokerages receive commissions from market makers (a small piece of the spread) in exchange for routing trade orders to these firms for execution. In 1997 the Securities and Exchange Commission (SEC) introduced new trading rules to limit the spread to make trading more equitable. This has resulted in decreased commissions for order flow.

3.1.3 Margin lending interest

Customers are able to borrow from their broker secured by the collateral they have in their brokerage account.

3.1.4 Interest earned on deposits

To ensure protection of customer assets, brokers (just like banks) are required to hold mandated amounts of assets (cash and cash equivalents) segregated in compliance with federal regulations. This cash earns interest that is part of broker revenue.

3.1.5 Extensions and cross-selling

E*Trade has been very aggressively repositioning itself over the last six months. It has moved from a discount brokerage to a financial portal. It has added mutual funds to date and has stated that insurance, loans and mortgages are coming soon. It already has partnerships with E-loan and others to be able to deliver on this strategy. Ameritrade has stated that it too will follow E*Trade's model, but currently has launched only a Beta investment site, called OnMoney, for existing customers. Quite clearly the business model for on-line brokerage is similar to mainstream financial services where developing and maintaining customer relationships and cross-selling are fundamental.

3.1.6 International Expansion

E*Trade has aggressively expanded internationally by means of franchising its brand and enabling technology. The strategy makes sense in the face of shrinking margins and tough competition in the home US market. It is also a sensible approach in that it minimizes risk and ensures some income by licensing rather than competing directly in foreign countries.

With the rise in Internet brokerages, fees have come under severe pressure. Both brokers have experienced consistently falling average per-trade fees, and neither expects this decline to reverse. There are indications, however, that fees are currently stable. This reduction in fees is however more than offset by increased customer numbers. The reduced fees have had a similarly adverse effect on the fees for order flow, with market makers lowering fees as their commission structure has been eroded. Additionally the SEC has changed the rules of the games limiting the amount that can be paid in commissions for order flow. With increased customer bases, interest income is expected to rise.

3.2 Market growth

There is data showing that as of 1999 some 30% of private trades are done on the Internet.

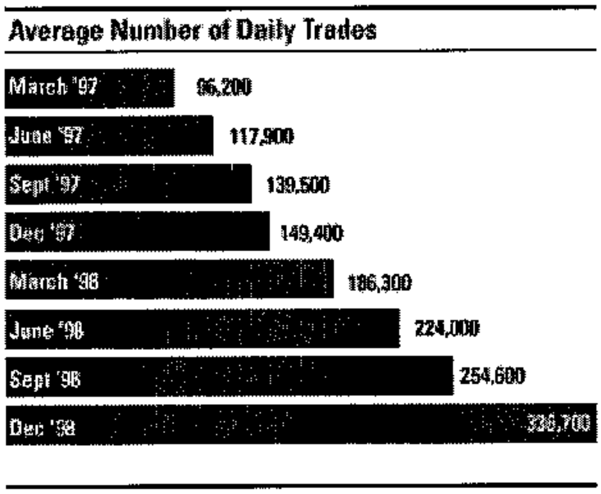


Fig 2: Industry Growth in Daily Trading Volumes

As on-line trading has taken off so has the number of on-line brokerages. In 1990 there were none. By February 1999 Gomez Advisors reported that there were 100 brokerages. It is the consensus opinion that the market cannot sustain this number - the only uncertainty is who will survive.

eMarketer; Monday, March 29, 1999; http://www.emarketer.com/enews/031599_barrons.html

4 AMERITRADE

Ameritrade's transition to the Internet can be traced back to 1988, when automated trading via touch-tone telephone was introduced. Ameritrade first offered on-line trading in 1995. In the just over three years since then, they have become a full-fledged on-line brokerage. The Ameritrade brand was born in March 1997 when it executed an IPO and in September 1997 merged four distinct brands (Ameritrade, Ceres, Aufhauser, and e-Broker) into the Ameritrade brand. Ameritrade Inc still maintains the smaller Accutrade brand, a fuller service brokerage at a higher price point. Accutrade remains small and does not materially distort the Ameritrade Inc quarterly reports and is thus ignored for the purposes of this report. Prior to September 1997 the four Ameritrade component brokerages had all operated in the discount brokerage sector. Ameritrade relies on fees and commissions and at $8 per trade are clearly targeting the extra-value segment. Ameritrade have announced plans to re-brand themselves as a "financial portal" cross-selling various financial products from a range of providers.

4.1 PRODUCT OFFERINGS

Retail customers have the ability to trade equity securities, options, mutual funds and bonds through the Internet, PC-based software, personal digital assistant, touch-tone telephone and facsimile as well as through a traditional registered representative. Depending on the medium used by the customer, trades may be executed for as little as $8 regardless of the number of shares bought or sold. This represents considerable savings over the trading fees charged by traditional full-commission brokers. In addition to lower transaction costs, the Company's retail discount brokerage customers are able to access a broad range of services designed to meet their individual needs, including real-time quotes, investment news, research and information.

5 E*TRADE

E*Trade, in contrast to Ameritrade, was always at the technological cutting edge. It has its roots in TradePlus, formed in 1982, as an on-line quote and trading service (c.f. Reuters or Bloomberg), using proprietary software and hardware, offered to brokerages. Later the service was offered directly to customers to allow them to bypass brokers. In 1992 TradePlus formed a subsidiary – E*Trade – offering customers on-line investing services through CompuServe, AOL and direct modem link. It also offered touch-tone phone service. In 1996 the company went public. The company offered basic execution service, relying on commissions and order flow, until the Fall of 1998. At this point they repositioned themselves as a "financial portal" and offered mutual funds, extensive information and have begun to build a range of cross-selling opportunities.

5.1 PRODUCT OFFERINGS

The Company offers automated order placement and execution, along with a suite of products and services that can be personalized, including portfolio tracking, Java-based charting and quote applications, real-time market commentary and analysis, news and other information services. E*Trade provides these services 24 hours a day, seven days a week by means of the Internet, touch-tone telephone, including interactive voice recognition, on-line service providers (America Online, AT&T WorldNet, CompuServe, Microsoft Network and Prodigy) and direct modem access.

Free resources available to the public on E*Trade's Web site include breaking financial news, real-time stock and option price quotes, company financial information and news announcements, live market commentary, personalized investment portfolios, investor community areas, and search and filtering tools for mutual fund and fixed income products. E*Trade's Web site services three levels of investors--visitors, members, and customers, with each successive group gaining access to additional value-added products and services. Visitors can view market information, headline news, stock quotes and charts, mutual fund information, and much more. By registering but not opening an account, a visitor becomes a member and receives free access to many advanced, customizable investment research tools, including free real-time quotes and secure email. Customers, those investors with E*Trade accounts, have complete access to E*Trade's trading engine and to all the investment research and management features, including Smart Alerts, and many sophisticated analytical and record keeping tools. Customers may also subscribe to E*Trade's Professional Edge service and receive access to IPO's, institutional quality research reports, and other premium services.

6 POSITIONING AND TARGETING

6.1 VALUE PROPOSITION

E*Trade and Ameritrade have taken the value proposition of a full-service brokerage and challenged it. In doing so they have truly revolutionized the industry. Fees have come down in quantum leaps, an industry (mainly profitable) has been created on the Internet, and now even Merrill Lynch is about to launch an on-line offering.

In the old paradigm, a full service broker offered advice, portfolio management and security. In return the fees charged were high.

The Internet model provides the individual investor with all the information they need to make informed decisions, security is guaranteed through SIPC (Securities Investor Protection Act) investment insurance, and the price for a trade has been slashed. The trade-off has been the removal of the human interface and personalized advice and asset management. This new model nonetheless has not only appealed to value and sophisticated investors alike, but has created a new segment of day traders. These are private investors who, with real time stock quotes and low commissions, can afford to rapidly trade in and out of stocks and profit from extremely short-term volatility.

In short, the value proposition is removal of information asymmetry, which delivers low cost, quick execution and real time information.

6.2 PRICING

The table below compares the pricing of the two services as well as eSchwab as a benchmark. eSchwab has been used owing to their pioneering role in defining the discount brokerage sector, and their continued market leadership on-line.

	AMERITRADE	E*TRADE	ESCHWAB
ON-LINE			
Listed	$8.00	$14.95	$29.95
Nasdaq	$8.00	$19.95	$29.95
TOUCH TONE			
Listed	$12.00	$14.95	$117.00
Nasdaq	$12.00	$19.95	$117.00
BROKER ASSISTED TRADE			
Listed	$18.00	$29.95	$130.00
Nasdaq	$18.00	$34.95	$130.00

Note: Pricing based on deal of 800 shares at $20.00

Fig 3: Pricing

6.3 SEGMENTATION AND TARGETING

The on-line investing community may be broken down into five broad categories[3], with each having different characteristics and needs.

6.3.1 Serious Investor

This segment typically is not new to investing and is confident taking decisions without a broker's advice. But high-quality information, investment tools, and research are necessary and extremely valuable to this segment. The value proposition likely to appeal is the aggregation of high quality and reliable data and products in one integrated, easily accessible place. Typical individual has reasonably high risk tolerance and high disposable income. Investment goal is typically focussed on high returns over the medium to long term.

6.3.2 Convenience Investor

This segment falls between the serious investor and the life goal planner. Convenience is as important as performance, and this segment values a comprehensive package of financial products (stock trading, mutual funds, credit cards, bill payment, and checking) from one supplier. Typical individual has moderate risk tolerance and varying disposable income. Investment goal is typically un-focussed and requiring a reasonable return.

6.3.3 Life-Goal Planner

This segment is more likely to invest in mutual funds than equities and is seeking long-term growth and wants tools for financial planning and portfolio optimization. A stable financial services provider is more important than the latest in technical analysis. Typical individual has reasonably low risk tolerance and moderate to high disposable income. Investment goal is typically focussed on above average returns for specific events over the longer term.

6.3.4 Day Trader

This segment makes investing their business and will be executing frequent trades each day. Low cost trading, a simple interface, and fast execution are crucial to this segment. Their trading is so frequent, they do not even want to re-enter their password on every order. Typical individual has very high risk tolerance and will be seeking a great interface and low fees. Information geared to day trading may also be valued. Investment goal is focussed on high returns over the 'nano' term.

[3] Adapted from Gomez Advisors, http://www.gomezadvisors.com

6.3.5 *High Net Worth Investor*

This segment will be investing millions of dollars over the longer term and value comprehensive asset and financial planning. Reputation, security and performance are key values for this segment. Additionally, personal relationships and contact are absolutely necessary to this segment.

Gomez Advisors have ranked all the on-line brokerages (see fig 4 below) for the various categories of investors. The table would suggest that Ameritrade, with it value positioning is targeting the Day Traders and Life Goal Investors. E*Trade, with its new portal approach (comprehensive products and information) appears to be targeting the Serious and Convenience Investors.

	INVESTOR TYPE			
	Serious	**Convenience**	**Life Goal**	**Day**
Ameritrade	15	19	8	3
E*Trade	3	8	12	20
Schwab	2	3	14	20+
Datek	10	12	4	1
DLJdirect	1	2	1	6
Your Discount Broker	13	1	18	13

Fig 4 : Rankings (Relative to All On-line Brokerages) By Investor Type[4]

[4] Gomez Advisors; March 1999; http://www.gomezadvisors.com

This targeting is further confirmed by Piper Jaffray, who report that Ameritrade account holders have higher assets and trade more frequently than E*Trade accounts. Yet the same information, when applied to E*Trade is less clear. It would be expected that E*Trade, in trying to mimic Schwab would have higher assets per account. It's all out drive to attract customers and its low opening minimum balance of $1000 might explain the low account balances.

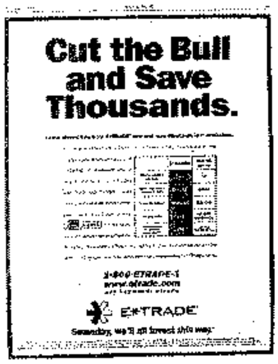
	Sept-98	Dec-98
ACCOUNTS		
Ameritrade	306,000	354,000
E*Trade	544,000	676,000
Schwab	2,000,000	2,200,000
Total On-line	5,849,000	7,253,000
ASSETS/ACCOUNT		
Ameritrade	37,000	42,000
E*Trade	21,000	22,000
Schwab	65,000	79,000
DLJdirect	14,000	17,000
Datek	20,000	24,000
Average	51,000	58,000
Merrill Lynch		140,000[5]
TRADES/QTR/ACCOUNT		
Ameritrade	4.0	4.9
E*Trade	3.5	4.2
Schwab	2.6	2.8
DLJdirect	1.5	1.7
Datek	12.3	15.5
Average	2.7	3.1

Fig 5: Customer Characteristics[6]

[5] Author's estimate from Wall Street Journal reports citing Private Client Assets and client number

[6] Piper Jaffray; Online Trading Update; Various dates

6.4 MESSAGE



E*Trade has copyrighted the slogan: "Some day we'll all invest this way". Their message is that using a broker is just silly. Unfortunately their message has hardly been consistent over the last two years, except for the slogan. Through 1997, there was primarily comparative price advertising, targeting Schwab and Merrill Lynch. These ads also induced investors to try on-line trading via the E*Trade game to try and stimulate primary demand. In 1998, the direct comparisons were dropped and the message was that brokers do not add much value (except for themselves) – rather E*Trade's information in an investor's hands creates true value. All ads prominently displayed Gomez Advisors number 1 overall rating. Through the year $50 incentives were offered on a number of occasions. Heavy emphasis was placed on the tools and investment information available on the new Destination E*Trade. Towards the end of the year, the comparative price theme was again used, with Merrill Lynch the target. The message that E*Trade is stressing is:

- E*Trade is value priced
- E*Trade offers the information and the mutual funds to allow you to handle your own investing – forget the broker.
- Your existing broker is fleecing you – leave him/her for E*Trade's no-broker world.

Unfortunately they do not emphasize some important considerations for potential switchers:

- Security (no prominent mention made of SIPC membership)
- Track record
- Live brokers are available to hold your hand if that's what you would prefer

Ameritrade have been extremely consistent, using the "8 buck" message to communicate an idea of fun and ease-of-use and emphasizing the low cost nature of the service. The headline is prominent and catchy e.g. "Buy a major Hollywood studio for $8", and invites the reader to read on. Their ads stress three things:

- Ameritrade is a deep discount broker
- You can trade on-line, by phone or use a broker
- Security – Ameritrade has been around for 25-plus years. SIPC benefits are also highlighted – protection of up to $500,000

By advertising that a minimum deposit of $2000 is required, they are also inviting a "better class" of investor to apply.

6.5 TARGETING

Neither brokerage appears to have taken a particularly segmented approach initially - hoping that all web investors would be attracted by the service. Their pricing has by default targeted the value segment and the "day-trader" segment. Both segments initially were likely to value the cheap trades, but now as more information becomes freely available, real-time quotes and research will be valued. As the web has matured more and more investors have turned to web trading - to which brokerage are they likely to be attracted?

It is difficult to see who exactly E*Trade is targeting. Will a Merrill Lynch investor (average account balance = $140,000), be that concerned with saving a little brokerage commission? Especially when E*Trade is not offering the advice, trusted research, and personal relationshin that Merrill is. Will the dav trader and Life Goal investor, concerned with value, trade with E*Trade who charges twice the fees of some other deep discount brokers? The segment that E*Trade does seem to have targeted are the "reluctant" on-line investor, those who will be seduced by the signing bonuses, the investing game and the low account opening balance of $1000.

On the other hand, Ameritrade's message is more consistent with the targets - segments who value low price and simplicity. These are the Day traders who are looking primarily for a cheap service and the Life-Goal investors who are looking for value, stability and simplicity.

Some limited information regarding customer churn is available for Ameritrade and E*Trade[8], and is of the order of 5-10%. This indicates that customer loyalty has not yet become an issue as the sector grows at its current pace. However, when growth flattens, the brokerage firms are going to be forced to determine exactly what their customers value, deliver the value and offer excellent service to retain their customers. As the on-line brokerage industry is growing at a rate of some 20% per quarter, the losers to date are the traditional full service brokerages. However, confidence in on-line brokerages is still limited as evidenced by the smaller individual account balances of the on-line brokerages.

6.6 DIFFERENTIATION

This is where players might become unstuck. The Internet makes differentiation extremely difficult. There are low barriers to entry and as the experience is generally impersonal and commoditized, differentiation is difficult. One point of differentiation has been utilizing the Internet as a channel rather than as the sole medium. This gives

[7] Credit Suisse First Boston; Analysts Reports; Various Dates
[8] Credit Suisse First Boston; EGRP: E*Trade announced earnings of $0.12; 01/06/98

Schwab a unique differentiation that the other 100 or so Internet only companies cannot duplicate.

Neither business is able to offer some of the elements that differentiate their competitors, such as:

- a brick and mortar option
- advice
- reputation and security
- full product range
- unique research

Both are competing on price and adding additional features such as third party research, resources, e-mail and others. But as quickly as one adds such offerings, so does the next one. The low barriers to entry ensure the playing field remains level. Neither has yet established compelling differentiation in a crowded marketplace. However, E*Trade has taken an aggressive approach to gaining market share, strategizing that the brokerage who reaches the middle game with the largest number of customers will profitably make it to the end-game. And fortunately it has deep enough pockets that allows it to pay more than $300 to acquire customers of dubious quality.

7 Market Share Growth

There is data available to show the two companies market share over the last two years. Unfortunately, the metrics used to determine share are imprecise. Some analysts use share of trades, some use number of accounts, some use total client assets. Even the definition of account is open to debate. A core accounts is defined as an account that has traded, on-line, in the past six months. Schwab on the other hand labels a core account one that has ever traded on-line. The following table instead uses total trades over a quarter, as an objective metric, to determine market share.

Market Share for Quarter Ended

	9/97	12/97	3/98	6/98	9/98	12/98
Ameritrade	3%	5%	6%	7%	7%	8%
E*Trade	15	14	12	11	10	12
Schwab	33	30	32	29	29	28
DLJdirect	6	5	4	5	4	4
Datek	7	8	7	8	8	10

Fig 6: Quarterly Market Share Data[9]

The following graphs shows core account growth for the two companies, derived from 10Q/K analysis (see Appendix 1), and trading growth rates for the industry[10].

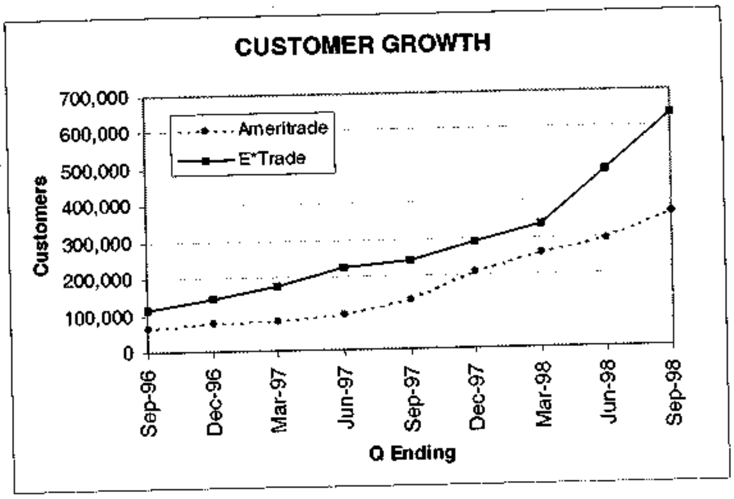


Fig 7: Core Account Growth

[9] Piper Jaffray; Online Trading Update; 3Q '97 to 4Q '98
[10] Piper Jaffray; Online Trading Update; Q3 97 to Q4 98

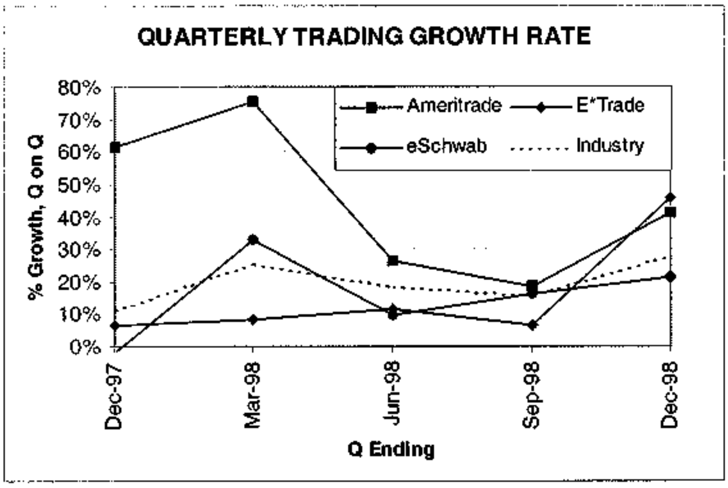


Fig 8: Growth in On-Line Trades

E*Trade began an aggressive advertising campaign in 1998, as can be seen in the figure below, following a classic "land grab" strategy. Ameritrade spent heavily at the end of 1997 (by then industry standards), but account growth has stayed smooth and strong through 1998. This is even in the face of reduced advertising, at level's just one fourth of E*Trade's. Ameritrade spent 18% of revenue on advertising in 1997 increasing to 32% in 1998. Corresponding spending for E*Trade was 18% and 29% in 1997 and 1998 respectively. This compares to a 1997 industry average[11] of 1.8%.

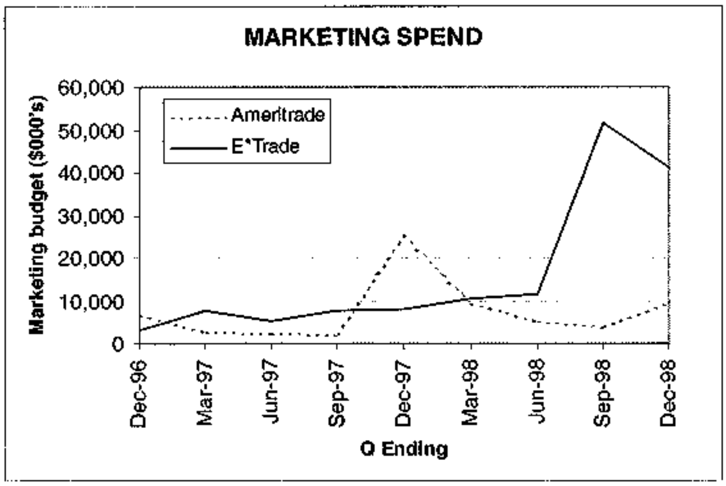


Fig 9: Marketing Spending

[11] 1997 advertising-to-sales ratios for the 299 largest ad spending industries; Advertising Age: http://www.adage.com

8 MARKETING EFFECTIVENESS

Marketing consists of a number of activities and includes the more quantifiable efforts of on-line and off-line advertising as well as direct marketing. It also includes public relations and word-of-mouth which in turn is driven largely by the company's ability to deliver on the value proposition. This relates directly to creating a "buzz' about the company and being able to operate without technical outages. The following section will discuss these and will attempt to determine who is spending money more wisely, and correlate this with where the money is being spent.

8.1 APPROACHES TO MARKETING

Prior to 1997, both companies relied heavily on direct marketing to attract new customers. This has changed radically with both companies spending ever increasing amounts to build brand identities that will attract customers at a sustainable cost into the future. To do this their fundamental strategies have been quite different. Ameritrade has concentrated heavily on television advertising, and it is assumed the remainder of unmeasured advertising dollars have gone to on-line advertising and marketing. In contrast E*Trade has also been very successful at crating a "buzz" budget into on-line approaches which has included both advertising but also increasingly is focused on alliances and partnerships with major web properties including AOL and Yahoo. E*Trade has also been very successful at crating a "buzz" with CEO Christos Cotsakos playing the role of charismatic, silicon valley e-entrepreneur very well. Ameritrade, based in Omaha Nebraska and with an older management has not been very active in courting publicity. Equally important for web companies, is how they perform technologically. E*Trade experienced a highly publicized system outage when it was overwhelmed by the volume of trades during a severe market correction in October 1997 (in fact is currently being sued over this). This still hurts the company's marketing efforts as well as the industry at large.

8.2 THE COST OF NEW ACCOUNTS

There are a number a way of measuring marketing effectiveness. The primary method is to calculate a cost per new account. This is the method favored by the analyst community. However this is simplistic and open to manipulation by the companies, and more importantly not all accounts are created equal! Any metric needs therefore to incorporate either some measure of customer quality or some measure of profitability.

To create a metric that includes both customer number and quality, the author has used the following approach. Given that the majority of income derives from trading commissions, it is implicit that the number of trades per customer is key, rather than just the number of customers. To eliminate the differing customer trading characteristics of the two companies I have calculated the number of "standard customers" each has, by defining a standard customer as one who trades 20 times per year. The 20-trade level is derived from statements by the companies as to how

[12] Webfinance; http://www.webfinance.net/newsite/members/wallstreet/04kwearn.html, 10k & lOq statements

often typical customers trade. The number of standard customers is simply the annual number of trades divided by 20.

As profitability derives principally from transaction revenues, a more useful metric is to track the cost of acquiring incremental new trades. Unfortunately, some mental gymnastics are then required to figure out the longer-term implication of these costs. To solve this problem, the author has defined the "Marketing Payback Period" - a measure of customer acquisition cost relative to customer profitability. The Marketing Payback Period, is the client acquisition cost divided by the pre-tax profit less marketing expenses, expressed in years. In the figure below it can be seen that the quality of E*Trade's new clients appears to be declining, and that it will now take 2.65 years to break even on the marketing spend.

It must be stated that some client acquisition costs, such as E*Trade's purchase of OptionsLink (a small asset management firm) or one-off marketing costs (e.g. agreements with AOL and Yahoo, ($10.6M) in Sept '98[13]) are not included in the marketing expense, and these reporting practices tend to paint a rosier picture than exists for E*Trade.

Utilizing the Standard Customer acquisition cost or the Marketing Payback Period, it is clear that Ameritrade's marketing effort is more cost effective than E*Trade's. It is also clear that E*Trade seems to be misleading investors in regard to its spectacularly growing customer base. It is enlightening to highlight that both Credit Suisse First Boston and Deutsche Bank[15] state that a client acquisition cost in the region of $500-600 is the maximum that can economically be justified. How close to this threshold is E*Trade, or indeed have they crossed it? And at these acquisition costs what future cross-selling opportunities do they have that are not included in these estimates?

	AMERITRADE			**E*TRADE**		
	FYE Sept 97	FYE Sept 98	YE Dec 98	FYE Sept 97	FYE Sept 98	**YE** Dec **98**
Annual Account acquisition cost/customer	**$454**	$263	$230	$214	$341	$334
"Standard Customer" Acquisition Cost	$329	$299	$139	$184	$602	$750
Marketing Payback Period = Account acquisition cost/customer - annual EBTM/customer (yrs)	1.28	**1.76**	0.47	0.92	2.36	2.92

Fig 10: Marketing Effectiveness (see also appendices 2 and 3)

[13] Piper Jaffray Inc; EGRP: Volatility leads to Rev, EPS shortfall; 10/15/98
[14] CSFB; EGRP: Initiating Coverage with a buy; 07/27/98
[15] Deutsche Bank; EGRP: Rearranging 1999 Quarterly Estimates; 11/12/98

8.3 MARKETING STRATEGY

The strategies of the two companies have been slightly different. Ameritrade has apparently adopted a concentrated frequency strategy for their communications – spending intensively on television exposure with a consistent advertising message, and then dropping back to maintenance levels. Part of the reason that they were able to do this was they moved early, when the market was spending conservatively, and out-advertised the competition. E*Trade has deep pockets and of late has adopted the "land-grab" paradigm in which no expense is spared to rapidly build a customer base, advertising both off-line and on-line with a large number of marketing alliances. They are currently not worrying too much about technical or service performance. This is the approach that AOL successfully adopted. However, it is questionable how well this strategy translates to financial services. Consumers are less likely, after all, to entrust their life savings to a provider who cannot offer system integrity and high levels of service. Whatever the switching costs, which are largely measured in terms of convenience and inertia, investors will move if they perceive that their money is not in the safest of hands. This is to some extent demonstrated today with the advice that many forums provide of maintaining at least two on-line accounts. In addition to the current low switching costs are the low barriers to entry, which have resulted in cutthroat price competition. Only the traditional brokers have managed to maintain any pricing power, typically charging twice as much as on-line brokerages. It is therefore up to these new companies to identify and deliver true value and to increase switching costs. Strategies to accomplish this could include such things as innovative new products, loyalty programs, bundling of related products and new levels in customer service and responsiveness. These strategies will become crucial to survival when exogenous forces, such as a bear market or a technology failure, cause the market to stop growing or even to decline.

8.4 MEDIA ALLOCATION

	1997		%		1998		%		Total		%	
	Ameritrade	E*Trade	Ameritrade	E*Trade	Ameritrade	E*Trade	Ameritrade	E*Trade	Ameritrade	E*Trade	Ameritrade	E*Trade
Total marketing Expense ($000)	32,282	29,077			28,315	114,722			60,597	143,799	10 0	
Measured Advertising ($000)												
Magazines	1,203	4,421	4	15	1,644	11,038	6	10	2,847	15,459	5	11
Newspaper	144	705	0	2		3,242	0	3	144	3,947	0	3
Television	24,510	8,324	76	29	10,573	19,289	37	17	35,083	27,613	58	19
Radio												
Total	25,857	13,450	80	46	12,217	33,569	43	29	38,074	47,019	63	33
Effectiveness												
Cost/Account	$485	$225			$123	$291			$204	$275		
Cost/Standard Account	$668	$190			$139	$750			$240	$470		

Fig 11: Media Allocation[16]

The information in the above figure refers to exhaustive measurement of off-line advertising. A simplifying assumption has been made that all non measured advertising is on-line advertising. This does not take into account such marketing expenses as promotions, sponsorships or public relations, which may in fact have been substantial.

From the figure above a number of observations can be made:
1. Ameritrade has concentrated more on off-line advertising, the inverse of E*Trade's approach.
2. Over two years, both have significantly stepped up their on-line marketing. For both companies less than half their 1998 advertising was placed off-line.
3. Over two years, Ameritrade's advertising appears to have been more effective, as indicated by both customer acquisition metrics

These observations tend to qualitatively indicate that a marketing campaign skewed more to off-line advertising is more effective. This is supported by Schwab's decision

[16] Ad $ Summary; Competitive Media Reporting, 1997, 1998

to scale back on banner advertising and non-exclusive sponsorships[17], citing the high cost of these activities.

Other reasons that Ameritrade's advertising may have been more cost effective:
1. They concentrated on television rather than print, possibly trying to create top-of-mind awareness. They would have been targeting non-sophisticated consumers, rather than sophisticated consumers who read investing/financial publications and would tend to base their brokerage decision on their own research.
2. The carry over period has been ignored. Both brokerages show high acquisition costs in the year that spending is increased, and then declining costs as the effects extend into the future. As E*Trade is still in the high spending phase, this introduces bias against them.
3. Similarly to the point above, new customers appear to trade less in their first year, thus inflating the acquisition cost of "standard customers".
4. There may be a point of diminishing return when spending is increased past a certain point, causing acquisition costs to increase dramatically.

The above discussion indicates only that Ameritrade has spent proportionately more on off-line media than E*Trade, and has seen more cost effective results. There is only inconclusive evidence to support the hypothesis that off-line spending is in fact more effective than on-line spending.

[17] "Bye Bye Banner: Schwab strategy disses clicks"; Brandweek; 10/26/98

9 CONCLUSION

This paper has examined the marketing strategies of Ameritrade and E*Trade, and concludes:

- Both are competing in the deep discount brokerage space, but Ameritrade offers the better value at $8 per trade, compared to E*Trade's $14.95. There are now over 100 brokerages competing in this space, up from close to zero just three years ago.
- Neither company has offered a sustainable and compelling value proposition yet. As information has become more freely available on the Internet, both have been competing on offering more and more information (which is not to be confused with advice) - not a unique and sustainable competitive advantage. Both are currently at different stages in developing themselves into financial web portals - again a strategy that is easily imitated.
- Ameritrade has been more focused in targeting value and life-goal customers, and have kept their advertising message consistent.
- E*Trade has been more "creative" in their marketing, spending less on traditional media and more on on-line sponsorships, advertising and alliances. Their lower marketing effectiveness might indicate that on-line marketing is less effective than off-line.
- It is difficult to obtain an objective reliable metric to gauge marketing effectiveness. Therefore the author defined the Acquisition Cost per Standard Account and the Marketing Payback Period. Over the two years examined, Ameritrade performed better on both metrics. E*Trade, as well as under-performing is trending upwards on both metrics.
- E*Trade's current strategy is to spend aggressively to acquire customers quickly, and then leverage this large customer base to grow individual trading revenue and cross selling opportunities. .
- E*Trade's current cost of acquiring customers is high, and may be difficult to justify economically. There is even the possibility they may be destroying rather than creating value.

From these conclusions it can be seen that Ameritrade has proven itself better at marketing than E*Trade, both from a financial standpoint and a marketing standpoint.. The fact that E*Trade is apparently overspending and is not very focused does not mean that it will not ultimately succeed and create enormous value. However, these are companies that compete in the Internet space and thus certain rules seem to be currently suspended by the market. In the end, Omaha based Ameritrade has remained at heart a discount brokerage, and has strategically and successfully exploited the Internet as a distribution, channel. Palo Alto based E*Trade, on the other hand, define themselves as an Internet financial services company with brokerage being just one of their portfolio of services. This leaves them wide open to the risk of not being sufficiently focused to deliver value to their various markets, and consequently the high price paid to acquire their customers might well will prove to be unsustainable.

10 POSTSCRIPT

This report covers the period from December 1996 to December 1998. Since December 1998, the stock price performance of the two companies has been spectacular. Ameritrade has outperformed, possibly confirming the conclusion of this report - Ameritrade currently has an economically more sustainable business model.

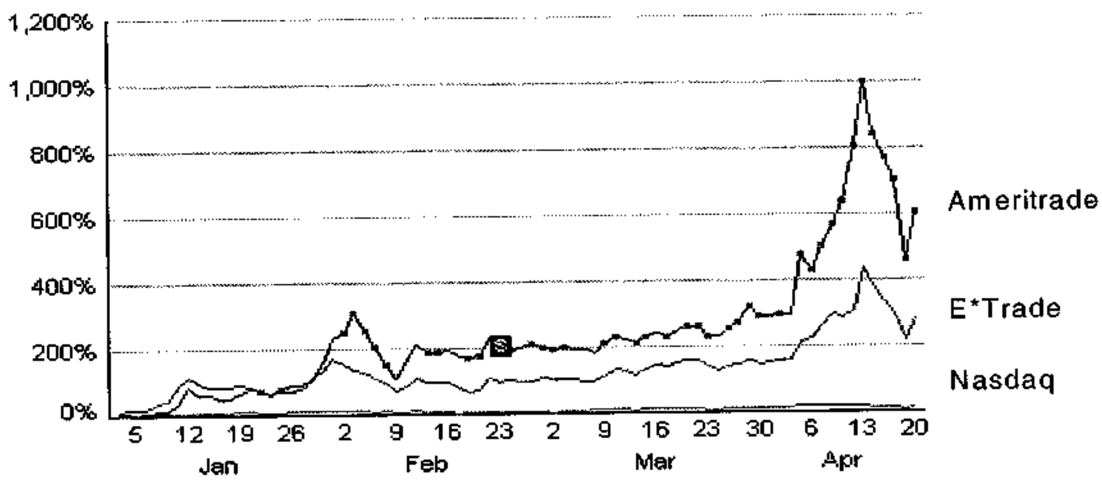


Fig 12: Stock Price Performance, 1999

11 APPENDICES

11.1 Appendix 1 – Customer Growth

		Quarter Ending									
		Sep-96	**Dec-96**	**Mar-97**	**Jun-97**	**Sep-97**	**Dec-97**	**Mar-98**	**Jun-98**	**Sep-98**	**Dec-98**
	Ameritrade										
1	As stated by company (10Q & 10K's)	52,000				98,000	132,000	205,000	262,000	306,000	354,000
2	Estimated (by trade volume of 5.5 trades/quarter)	52,000	67,000	74,592	76,425	103,091	121,636	201,474	245,265	274,909	383,601
3	As reported by CSFB analysts	53,000		81,000	91,000	98,000	147,000	217,000	267,000	306,000	354,000
	Average 1, 2 & 3	**52,333**	**67,000**	**77,796**	**83,712**	**99,697**	**133,545**	**207,825**	**258,088**	**295,636**	**363,867**
	E*Trade										
a	As stated by company (10Q & 10K's)	91,000				225,000				544,000	
b	Estimated by stated (10Q/K) trades per account	91,000	118,307	149,775	179,352	225,000	219,727	222,796	256,278	544,000	792,714
c	Estimated (by trade volume of 5.5 trades/quarter)	96,153	107,972	141,150	163,608	229,702	247,059	250,510	288,157	296,627	439,216
d	As reported by CSFB analysts	90,970	112,800	145,000	182,000	225,000	260,000	403,000	459,000	544,000	676,000
	Average a, b, c, d	**92,281**	**113,026**	**145,308**	**174,987**	**226,176**	**242,262**	**292,102**	**334,478**	**482,157**	**635,977**

CSFB: Credit Suisse First Boston

11.2 Appendix 2 - E*Trade Income Statement[18]

		Year Ended			Q Ended
		Sep-96	Sep-97	Sep-98	Dec-98
a	Transaction revenues	44,178	109,659	162,097	60,320
b	Interest, net of interest Expense	4,813	25,265	56,019	21,644
c	International		4,000	7,031	1,140
d	Other	13,529	17,471	20,135	4,969
e	Net revenues	62,520	156,395	245,282	88,073
f	Cost of services	38,027	73,381	111,832	41,171
g	Selling and marketing	10,944	28,160	71,293	40,929
h	Technology development	4,699	13,547	32,916	14,322
j	General and administrative	8,238	16,847	30,906	14,416
k	Total cost of services and operating expenses	61,908	131,935	246,947	110,838
l	Pre-tax income (loss)	612	24,460	-1,665	-22,765
m	Income tax expense (benefit)..	-555	9,425	-953	-9,572
n	Net income (loss)	$1,167	$15,035	($712)	($13,193)
	ANALYSIS				
o	Pre-tax income before marketing expense (EBTM)	11,556	52,620	69,628	18,164
p	Marketing as % of revenue	18%	18%	29%	46%
q	Number of customers	92,281	226,176	482,157	635,977
r	Revenue/customer	$677	$691	$509	$138
s	EBTM /customer	$125	$233	$144	$29
t	Commission revenue/customer	$479	$485	$336	$95
u	Net Interest revenue per customer	$52	$112	$116	$34
v	Direct revenue/customer	$531	$597	$452	$129
w	Account acquisition cost/customer		$214	$341	$334
x	Marketing Payback Period = Account acquisition cost/customer / annual EBTM/customer (=w/s)		0.92	2.36	2.92
y	New Trades/yr		2,627,600	2,720,600	3,058,600
z	"Standard Customers" Acquired (y/20)		131,380	136,030	152,930
aa	"Standard Customer" Acquisition Cost (g/z)		$184	$602	$750
bb	Total Trades		4,240,400	6,961,000	2,800,000
cc	Operating Cost/trade		$24	$25	$25

[18] E*Trade 10k, 1996-1998, 10q Dec. 1998 and author analysis

11.3 APPENDIX 3 - AMERITRADE - INCOME STATEMENT[19]

		Year Ended			Q Ended
		Sep-96	Sep-97	Sep-98	Dec-98
a	Commissions and clearing fees	$36,470	$51,937	$85,644	36,713
b	Net Interest revenue	11,478	18,194	37,437	13,180
c	Equity income (loss) from investments	3,359	3,444	5,083	-
d	Other	3,032	3,663	6,751	2,223
e	Net revenues	54,339	77,238	134,915	52,117
f	Employee compensation and benefits	14,050	19,291	36,083	13,432
g	Commissions and clearance	2,531	3,320	5,762	1,866
h	Communications	3,686	5,623	12,926	3,453
j	Occupancy and equipment costs	2,890	5,423	10,622	4,122
k	Advertising	7,537	13,971	43,614	9,643
l	Other	5,228	8,185	25,377	13,709
m	Total expenses	35,922	55,813	134,384	46,225
n	Income before provision for income taxes	18,417	21,425	531	5,892
o	Provision for income taxes	7,259	7,603	321	2,150
p	Net income	$11,158	$13,822	$210	$3,742
	ANALYSIS				
q	Pre-tax income before marketing expense (EBTM)	18,695	35,396	44,145	44,146
r	Marketing as % of revenue	14%	18%	32%	19%
s	Number of customers	52,333	99,697	295,636	363,867
t	Revenue/customer	$1,038	$775	$456	$143
u	EBTM /customer	$357	$355	$149	$121
v	Commission revenue/customer	$697	$521	$290	$101
w	Net Interest revenue per customer	$219	$182	$127	$36
x	Direct revenue/customer	$916	$703	$416	$137
y	Account acquisition cost/customer		$454	$263	$230
z	Marketing Payback Period = Account acquisition cost/customer / annual EBTM/customer (=y/u)		1.28	1.76	0.47
aa	New Trades/yr		849,744	2,918,752	4,080,303
bb	"Standard Customers" Acquired (z/20)		42,487	145,938	204,015
cc	"Standard Customer" Acquisition Cost (k/bb)		$329	$299	$139
dd	Total trades		1,781,924	4,700,676	2,109,807
ee	Operating Cost/trade		$23	$19	$17

[19] Ameritrade 10k, 1997,1998: 10q Dec 1998 and author analysis

11.4 APPENDIX 4 - E*TRADE - SELECTED CONTENT PARTNERS[20]

Content such as news, quotes, charts and fundamental data help provide investors with the information necessary to make investment decisions. The Company believes that these information services facilitate new ideas and increase transaction volume. The Company's partnerships with leading content providers fulfill customers'information needs and help drive transaction volume.

Reuters Reality Online - provides news, quotes, and company news providing customers with up to the minute world class news and information services.

BancBoston/Robertson Stephens - provides research and analysis.

BASELINE Financial Services - available to customers free of charge providing customers with access to a wide array of investment fundamentals, First Call earnings estimates and historical prices on over 6,500 stocks

Briefing.com - a service of Charter Media, Inc., provides continuously updated market commentary and analysis to E* Trade customers free of charge.

INVESTools - The Company has entered into a revenue sharing agreement with INVESTools which provides E* Trade customers with direct access to 25 brand-name research reports and newsletters plus stock screening tools on a pay-per-use basis.

QUOTE.com - provides current news and charts that are directly linked to E* Trade customers' stock watch portfolio and quote lookup features. News provided includes Reuters News, PR Newswire and BusinessWire.

IDD Enterprises - provides mutual fund profiles and two types of screening tools (Quick Fund Search and Advanced Fund Search) within the E*TRADE Mutual Fund Center.

Morningstar, Inc - provides performance information and proprietary "star" ratings on mutual funds within the E* Trade Mutual Fund Center.

[20] E*Trade 10k report, September 1998

11.5 Appendix 5 - E*Trade - Selected Marketing Partner Sites[21]

The Company has developed alliances with key channels in the on-line medium to increase account development and expand distribution. These channels include proprietary on-line services, internet service providers and popular destination Web sites such as search engines or financial content providers. These channels attract significant numbers of users, and the Company's relationships provide access to expanded market opportunities.

America Online - In July 1998, the Company entered into a two year agreement (at a cost of $25M) with AOL, that allows direct access to E*Trade's Web site from the AOL Brokerage Center. E*Trade is one of four exclusive sponsors of that area. The agreement provides for extensive marketing and promotional programs across AOL properties.

Yahoo! - provides direct access from the Quotes area of Yahoo! Finance to E*Trade's Web site. In August 1998, the agreement was expanded to include extensive advertising, sponsorship, and promotional programs throughout Yahoo! Finance and related areas of the Yahoo! Network of properties as well as a number of unique targeted marketing and promotional programs created for E*Trade to directly reach the millions of Yahoo! Finance registered users. The Company is also sponsoring two highly popular areas of Yahoo!, Financial News and Insider Trading, as well as renewing its position as one of the premier merchants in Yahoo! Finance.

E-Loan - In January 1998, the Company entered into a three year agreement with E-Loan, Inc., a privately held multi-lender Internet mortgage company, to prominently feature links to the Company's On-line investment services from the E-Loan Web site. In addition, E-Loan is to be the exclusive multi-lender partner providing home loans through E*Trade's Web site.

InsWeb - The Company has entered into an agreement with InsWeb, a leading Internet insurance marketplace, that allows consumers to comparison shop for insurance. InsWeb provides a co-branded area on the E*Trade Web site that extends E*Trade's reach into additional financial products and services.

GeoCities - The Company has entered into an agreement with GeoCities, one of the largest providers of personal Web sites and communities on the Internet. GeoCities will provide extensive marketing, promotional, and branding programs for E*Trade throughout the GeoCities Wall Street community.

ZDNet - The Company has entered into an agreement with ZDNet, Ziff-Davis' Internet site and a leading site in news, information and entertainment category. The agreement calls for the Company to be the exclusive provider of on-line investment tools, including a portfolio manager and E*Trade's stock market game to ZDNet's customer base.

[21] E*Trade 10k report, September 1998

CBS SportsLine - In May 1998, the Company entered into a comprehensive co-marketing agreement which makes the Company the exclusive category sponsor of the CBS SportsLine/MarketWatch Business & Financial Arena. This co-marketing agreement also includes the Company's branded banners running throughout special promotions on CBS SportsLine and GolfWeb and the exchange of branded content, tools and technology, ensuring that the best offerings of each site are available to the Company's customers.

SinaNet - The Company has an exclusive agreement to promote its Internet- based investing services to Chinese-speaking investors in the United States through SinaNet, Inc., a media company which has created a popular Chinese-language Web site in North America.

WebTV Networks - The Company has an agreement whereby E* Trade has an entrance page available to WebTV Network subscribers from the Investing and Brokerage section of the WebTV Network where it is prominently featured.

11.6 Appendix 6 – Smartmoney Ratings[22]

Brokerage	Overall	Commissions[1]	Fees[2]	Products	Research	Real Time	Services[3]	Support	Site Evaluation
Discover Brokerage Direct	4	12	11	4	8	2	10	12	3
Datek	6	4	19	17	16	2	19	9	1
E*Trade	**7**	**14**	**16**	**1**	**8**	**1**	**8**	**17**	**7**
DLJdirect	8	17	12	7	4	9	1	7	9
Charles Schwab	12	20	8	7	1	9	2	14	1
Ameritrade	**14**	**4**	**17**	**14**	**15**	**9**	**3**	**11**	**15**
National Discount Brokers	16	13	15	11	18	9	8	18	8

Extract from survey of top 20 brokers

[1] Commissions: pricing for trades ranging 500 shares in a limit order to 5,500 shares of a listed stock
[2] Fees: for setting up IRA's, bounced checks, margin trading etc.
[3] Services: include free check writing, debit cards, cash management accounts, email notification of stock target price, after-hour trading

http://www. smartmoney. com/si/brokers/online/index. cfm?story=stack

11.7 APPENDIX 7 – KIPLINGER RATINGS[23]

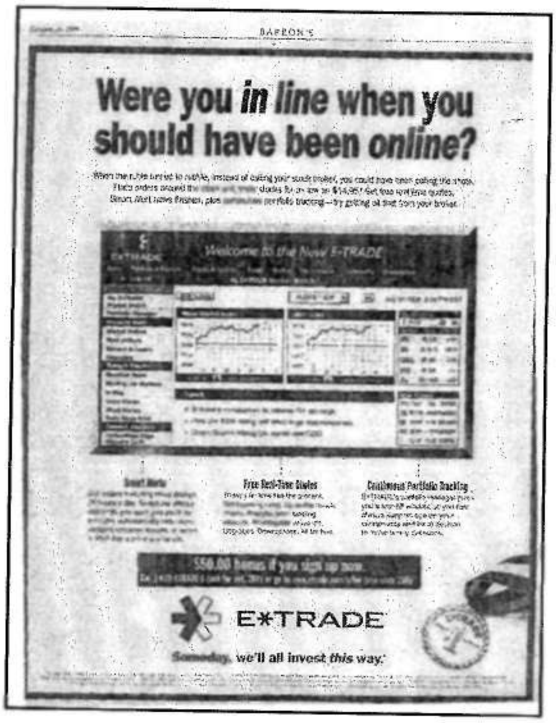
Name		IRA	Mutual Funds				Tools		
	Minimum to Open Account	Minimum to Open/ Annual Fee/ Fee to Close	Money-Fund Yield* With Sweep	No-Load, No Fee Funds	Fee For No Load Funds §	Frequency of Account Updates	Web Site	Research	Phone/Email Response Time
Accutrade	$5,000	$2,000/$0/ $25*	4.66%	657	27.00	daily	B	B	A/C
American Express	2,000	0/29/50	4.62	220	—	20mins	D	C	B/A
Ameritrade	**2,000**	**2,000/0/ 25**	**4.75**	**none**	**18.00**	**daily**	**A**	**B**	**A/F**
Brown&Co.	15,000	5,000/0/0	No sweep	none	—	daily	C	F	A/NA
Bull&Bear	0	0/0/50	4.71	6	38.40‡	realtime	C	B	C/C
Datek	2,000	2,000/40/6 0	No sweep	none	9.99	realtime	B	C	B/D
Discover	2,000	2,000/0/50	4.80	237	25.00	realtime	B	C	A/F
DLJdirect	0	0/35†/50	4.65	719	35.00	daily	A	A	C/B
E*Trade	**1,000**	**1,000/0/ 20**	**4.67**	**500**	**39.95 ‡**	**daily**	**A**	**B**	**B/B**
Fidelity	5,000	500/24†/5 0	5.36**	945	28.95	daily	C	B	B/B
NDB	0	0/35†/50	4.66	788	20.00	20mins.	C	C	B/F
Quick&Reilly	0	0/0/50	4.8	335	25.00	daily	B	A	A/A
Schwab	2,500	500/29†/0	5.04	947	56.00‡	daily	A	B	B/F
Suretrade	0	0/0/0	No sweep	335	25.00	daily	B	A	F/A
Waterhouse	2,000	0/0/25†	5.03	1,023	25.00	realtime	A	B	B/C
WebStreet	0	0/0/50	4.80	none	25.00	realtime	A	B	C/B

* Applies only to those under age 59.5
NA not applicable
‡ For $10,000 worth of funds
For prospective customers
30-day annualized yield for highest-yielding taxable fund
** Applies to sweep fund available only to retirement accounts; Fidelity's other sweep funds are tax-exempt
† Waived for large accounts or with specific number of trades
§ Outside the no-transaction-fee program

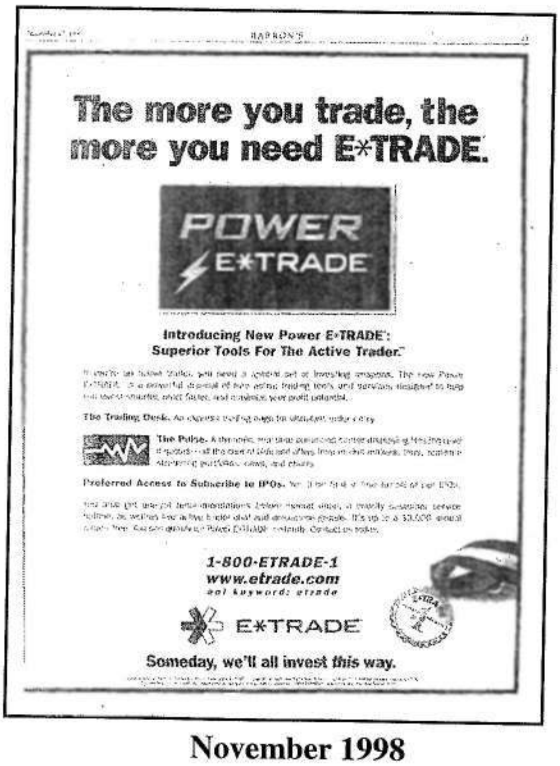
[23] http://www.kiplinger.com/magazine/index.html?archives/1998/October/ebroker.htm

11.8 APPENDIX 8 – SELECTED ADVERTISEMENTS FROM BARRONS

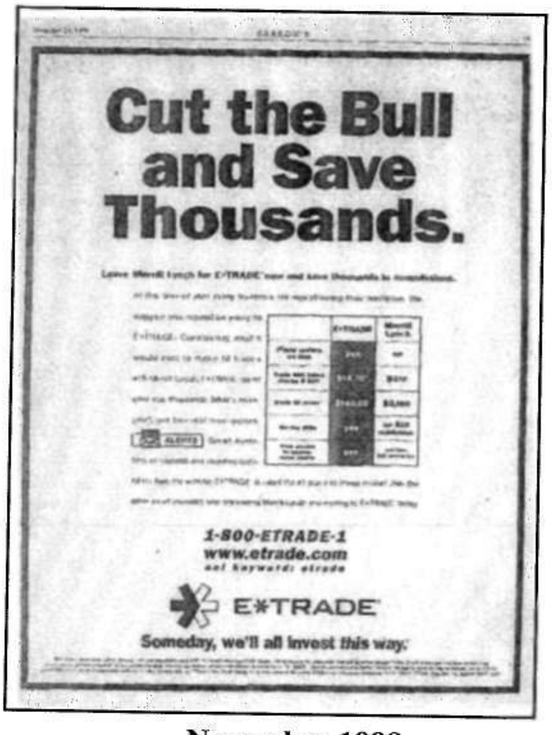
July 1997



September 1998

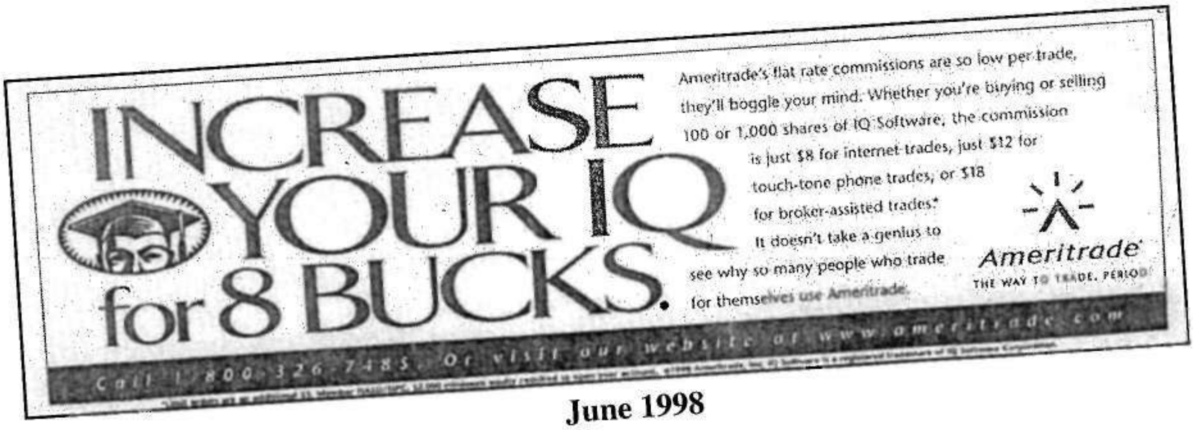


November 1998



November 1998

October 1997



June 1998